



Appendix A

Supporting evidence provided by First Actuarial to the Fire Brigades Union response to the Consultation Document: *“Firefighters’ Pension Scheme (1992) and New Firefighters’ Pension Scheme (2006) Proposed increases to employee contribution rates, effective from 1 April 2012 - consultation”*

REPORT PREPARED BY FIRST ACTUARIAL FOR THE FIRE BRIGADES UNION: ANALYSIS OF DATA – FIREFIGHTERS’ PENSION SCHEMES

INTRODUCTION

On behalf of First Actuarial, I am pleased to be able to provide my report with evidence which can be included in the Fire Brigades Union response to the Consultation Document of September 2011 entitled *“Proposed increases to employee contribution rates, effective from 1 April 2012 - consultation”* (referred to throughout this response as “the Consultation Document”).

We have set out below some general comments in relation to the proposed contribution increases for the Firefighters’ Pension Scheme (FPS) and the New Firefighters’ Pension Scheme (NFPS). We have then provided answers where appropriate to the specific questions posed in the Consultation Document. First Actuarial has previously provided a report to the FBU on the Impact of Government’s proposals for members of the FPS and the NFPS which has been submitted by them as part of a submission “Protecting good quality occupational pensions in the fire and rescue service: the initial approach of the Fire Brigades Union”. Our previous report covered a wider scope than this Consultation Document which relates only to the employee contribution increase proposals but it is important that cognisance is taken of the earlier report to recognise the full effects of the overall proposals.

Rob Hammond

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APPENDIX A TO THE FIRE BRIGADES UNION RESPONSE TO THE CONSULTATION DOCUMENT: FIREFIGHTERS’ PENSION SCHEME (1992) AND NEW FIREFIGHTERS’ PENSION SCHEME (2006) PROPOSED INCREASES TO EMPLOYEE CONTRIBUTION RATES, EFFECTIVE FROM 1 APRIL 2012

GENERAL COMMENTS

Government has proposed that employee contributions should increase from 2012-13 (with no immediate change to scheme benefits in either the FPS or NFPS other than the indexation factor which is subject to an ongoing legal challenge) and should deliver savings equivalent to an average increase of 3.2% points in employee contributions by 2014-15.

Government has further stated that any proposed increase in contributions should protect low earners and be progressive, that is, higher earners should pay proportionally higher increases to reflect their more generous pensions. Further parameters include:

- No increase in employee contributions for those earning less than £15,000;
- No more than a 1.5% point increase in total by 2014-15 for those earning up to £21,000. This amounts to a 0.6% point cap in 2012-13 on a pro-rata basis;
- High earners will pay more, but no more than 6% points (before tax relief) by 2014-15. This amounts to a 2.4% point cap in 2012-13 on a pro-rata basis.

First Actuarial recognise that no members of either the FPS or the NFPS have a full-time equivalent pay of less than £15,000. In fact, no members of either scheme have a full-time equivalent pay of less than £21,000¹ reflecting that the full-time starting salary for a firefighter is a little over £20,000. Therefore, the first and second parameters above which are aimed at protecting low earners are redundant.

Another important comment is that the Consultation Document only invites views relating to the proposed increases for 2012-13. It would be far better to consult now on the proposed increases in 2012-13 and those for 2013-14 and 2014-15, to fully assess the impact of the proposed increases on members' behaviour and the ability or otherwise of the proposal to meet the objectives set by the Government in the Spending Review.

We understand from DCLG that the Government's policy is to deliver 3.2% point savings from the FPS and NFPS by 2014-15, and not an actual cash amount of savings. Andrew Cornelius informed FBU in an email to Sean Starbuck dated 7 November 2011 that:

“...As we have discussed previously, the Government's policy is to deliver 3.2pp savings from the firefighters' pension schemes at 2014/15, not £33 million. If the pay bill is lower, or indeed higher, in 2014/15, the Government would still expect to see savings of 3.2pp...”

¹ Source: Summary of projected membership of FPS and NFPS as at 2014-15, email from Victoria Edwards to Natalie Ogden dated 4 November 2011.

It is questionable why the Government is focused on achieving an explicit increase in employee contributions rather than focusing on the actual cash saving over the three years to April 2015. For example, if as evidenced by the FBU in the YouGov survey findings, there are significant opt-outs by firefighters from either of the schemes then the short term savings that an increase in employee contributions is aimed at achieving would not be borne out and in fact the reverse could happen if less contributions are received as a result.

In his review of public service pension schemes, Lord Hutton recommended an increase to employee contributions solely for the purpose of making short term cash savings and only in response to a direct question from Government on the most effective way to achieve short term savings. He did not recommend an increase in employee contributions for any other reason or as part of his long term structural reform recommendations.

Finally, the Consultation Document does not provide any information on the proposed structure of employee contribution rates in relation to the benefits building up from April 2015. It is expected that the cost of benefits building up after April 2015 will be lower than the current level of benefits and therefore it would be reasonable to expect a lower employee contribution rate would apply after April 2015. It is also questionable whether a tiered contribution rate is justifiable for a Career Average Revalued Earnings (CARE) scheme which is the proposed structure for the new public service pension schemes.

Many of these concerns have been raised by the FBU and have been previously submitted as initial evidence.

Clearly new entrants from April 2015 should not be required to pay a proportion of their pension contributions towards the retention of a final salary link for those members with benefits built up before April 2015. This would be grossly unfair and an easily avoidable cross-subsidy. We comment further on this in Question 2 below.

In the rest of this response, we provide answers to the specific questions posed in the Consultation Document setting out our views and providing evidence we believe should be taken into account in the design of employee contributions over the period from April 2012 to April 2015 and beyond.

RESPONSES TO QUESTIONS POSED IN “FIREFIGHTERS’ PENSION SCHEME (1992) AND NEW FIREFIGHTERS’ PENSION SCHEME (2006) PROPOSED INCREASES TO EMPLOYEE CONTRIBUTION RATES, EFFECTIVE FROM 1 APRIL 2012 – CONSULTATION”

Q1. Do the proposed tiered contributions meet the objectives set out by the Government in the Spending Review?

RESPONSE: The Consultation Document only sets out the proposed employee contribution rates from April 2012. In order to answer this question, i.e. whether the proposed employee contributions will meet Government’s objective of generating savings equivalent to 3.2% by April 2015, we need to consider the proposed increase to employee contributions from April 2012 to April 2015.

Although not contained in the Consultation Document, we understand from DCLG that the proposed contributions for 2013-14 and 2014-2015 for the FPS and NFPS are as follows:

FPS	Cumulative % increase			Revised contribution 2014-15
	2012-13	2013-14	2014-15	
Pensionable pay band				
up to £15,000	0.0%	0.0%	0.0%	11.0%
£15,001 - £21,000	0.6%	1.2%	1.5%	12.5%
£21,001 - £30,000	1.3%	2.6%	3.2%	14.2%
£30,001 - £40,000	1.4%	2.8%	3.5%	14.5%
£40,001 - £50,000	1.6%	3.2%	4.0%	15.0%
£50,001 - £60,000	1.8%	3.6%	4.5%	15.5%
£60,001 - £100,001	2.0%	4.0%	5.0%	16.0%
£100,001 - £120,000	2.1%	4.2%	5.5%	16.5%
more than £120,000	2.3%	4.6%	6.0%	17.0%

Source: Proposed increases for 2012-13 taken from the consultation document, September 2011. Proposed increases for 2013-14 and 2014-15 provided by DCLG

NFPS	Cumulative % increase			Revised contribution 2014-15
	2012-13	2013-14	2014-15	
Pensionable pay band				
up to £15,000	0.0%	0.0%	0.0%	8.5%
£15,001 - £21,000	0.6%	1.2%	1.5%	10.0%
£21,001 - £30,000	0.6%	1.2%	1.5%	10.0%
£30,001 - £40,000	0.8%	1.6%	2.0%	10.5%
£40,001 - £50,000	0.9%	1.8%	2.2%	10.7%
£50,001 - £60,000	1.0%	2.0%	2.4%	10.9%
£60,001 - £100,001	1.1%	2.2%	2.6%	11.1%
£100,001 - £120,000	1.2%	2.4%	3.0%	11.5%
more than £120,000	1.3%	2.6%	3.2%	11.7%

Source: Proposed increases for 2012-13 taken from the consultation document, September 2011. Proposed increases for 2013-14 and 2014-15 provided by DCLG

Using information on the proportion of members of the FPS and NFPS in each of the pensionable pay bands (as provided by DCLG and shown in the Appendix) the weighted average of pension contributions from April 2012 to April 2015 is as follows:

Scheme	Contribution Rate for 2011-2012	Contribution Rate for 2012-2013	Contribution Rate for 2013-2014	Contribution Rate for 2014-2015
Weighted Average in FPS	11.0%	12.4%	13.8%	14.5%
Weighted Average in NFPS	8.5%	9.1%	9.7%	10.0%
Combined	10.7%	12.0%	13.3%	13.9%

Source: First Actuarial calculations

The above table shows that, assuming no change to the profile of the membership of the FPS and the NFPS, the weighted average contribution rate for 2014-15 could be around 13.9%. That is, it will be around 3.2% above the current weighted average contribution rate. So, the proposed tiered contribution structure appears to meet the Government's objective.

However, as explained in Question 2 below, this is only on the assumption that the profile of the membership of the schemes does not change over the period and in particular that a significant reduction in membership (possibly as a result of opt-outs caused by increases to employee contributions) does not occur. Such a reduction in membership would reduce actual cash income for the schemes and given that pensions (and other benefits) still need to be paid regardless of the contribution income received by the schemes, the savings that Government is aiming to achieve would be wiped out.

Further, due to the tiered structure of the proposed contribution rates, if a greater proportion of higher earners opt-out than lower earners (possibly as a result of the very high employee contribution rates being required) then the Government's objective may not be met. For

example, assuming that members opt-out of the schemes once they are required to contribute more than 14.2% (i.e. more than the average 3.2% increase in employee contributions announced by Government), the weighted average of pension contributions from April 2012 to April 2015 could be as follows:

Scheme	Contribution Rate for 2011-2012	Contribution Rate for 2012-2013	Contribution Rate for 2013-2014	Contribution Rate for 2014-2015
Weighted Average in FPS	11.0%	12.4%	13.8%	14.2%
Weighted Average in NFPS	8.5%	9.1%	9.7%	10.0%
Combined	10.7%	12.0%	13.2%	13.1%

So, the weighted average contribution rate for 2014-15 could be around 13.1%. That is, only 2.4% above the current weighted average contribution rate and hence the Government's objective would not be met.

A greater proportion of opt-outs of lower earnings would increase the weighted average contribution rate, however, this would be likely to increase the "true cost" of pensions which are higher for members with higher salary growth expectations (which could be argued to be the case for higher earners). In either case, a reduction in the number of members as a result of opt-outs whether these be from higher earner or lower earners, would result in a reduction in the net income for the schemes and remove the short term savings that Government is aiming to achieve.

Q2. Are there any consequences of the proposed contributions tiers that you consider have not been addressed?

RESPONSE: We have considered the following consequences of the proposed tiered contribution structure:

- Protection for low earners
- Potential effect on cash flow for the schemes as a result of possible opt-outs
- Aspirations for promotion
- Justification for tiered contribution structure in a CARE scheme

Protection for low earners

No members of either the FPS or the NFPS have a full-time equivalent pay of less than £15,000. In fact, no members of either scheme have a full-time equivalent pay of less than £21,000² reflecting that the full-time starting salary for a firefighter is a little over £20,000.

Therefore, the Government's aim to protect low earners such that those earning less than £15,000 will see no increase in employee contributions is redundant. As is the protection for those earning between £15,000 and £21,000.

Potential effect on cash flow

In our opinion, the effect of opt-outs on the cash flows of the FPS and NFPS has not been addressed.

FBU carried out a YouGov survey which ran from 18 May 2011 to 17 June 2011. The total sample size was 7,981 current Fire Brigade Union members. The main points of the YouGov survey were:

- 97% of members opposed the plans for firefighters to work 5 more years until age 60.
- Nearly two-thirds (62%) of respondents indicated that the pension changes were likely to affect their decision to apply for future promotion. We comment further on this below.
- 91% said they opposed plans to increase the current rate of pension contributions. 45% said they would actually consider leaving the profession if the contribution rates were increased.
- **27% said they would be likely or very likely to opt out of the pension scheme.**

² Source: Summary of projected membership of FPS and NFPS as at 2014-15, email from Victoria Edwards to Natalie Ogden dated 4 November 2011.

- At younger ages this figure is higher with up to 41% of 18 to 29 year olds indicating that they would be likely to opt out of the pension scheme if the proposal to increase member contributions is implemented.

Notwithstanding that the results of an anonymous survey are likely to show a bigger proportion of members saying that they are likely to opt out of the scheme than would actually do so, the principal finding of the survey is that a large number of firefighters would opt out of their pension scheme if increased contributions are imposed. 27% said they would be likely or very likely to opt out of the pension scheme.

To project the cash flow of the schemes we have used income and expenditure income from the “Statistical Release of the Firefighters’ Pension Income and Expenditure, dated 29 July 2011” for the years ending April 2009, 2010 and 2011 as shown in the table below.

Firefighters’ Income & Expenditure			
Income	Year 2008-09 (£m)	Year 2009-10 (£m)	Year 2010-11 (£m)
Employee contributions	108.7	107.3	105.6
Employer contributions	203.5	198.5	193.7
Ill health income	6.5	4.3	3.7
Miscellaneous income	5.1	23.8	0.0
Transfers in	8.8	9.1	6.2
Total income	332.7	342.9	309.1
Expenditure	Year 2008-09 (£m)	Year 2009-10 (£m)	Year 2010-11 (£m)
Benefits Paid	588.3	633.6	600.2
<i>of which</i>			
<i>commutation payments</i>	166.4	170.8	132.4
<i>recurring payments</i>	422.1	462.7	471.0
Transfers out	2.5	9.1	4.0
Miscellaneous expenditure	0.5	2.0	0.7
Total expenditure	591.3	644.8	604.9
Net Cashflow	(258.7)	(301.9)	(295.7)

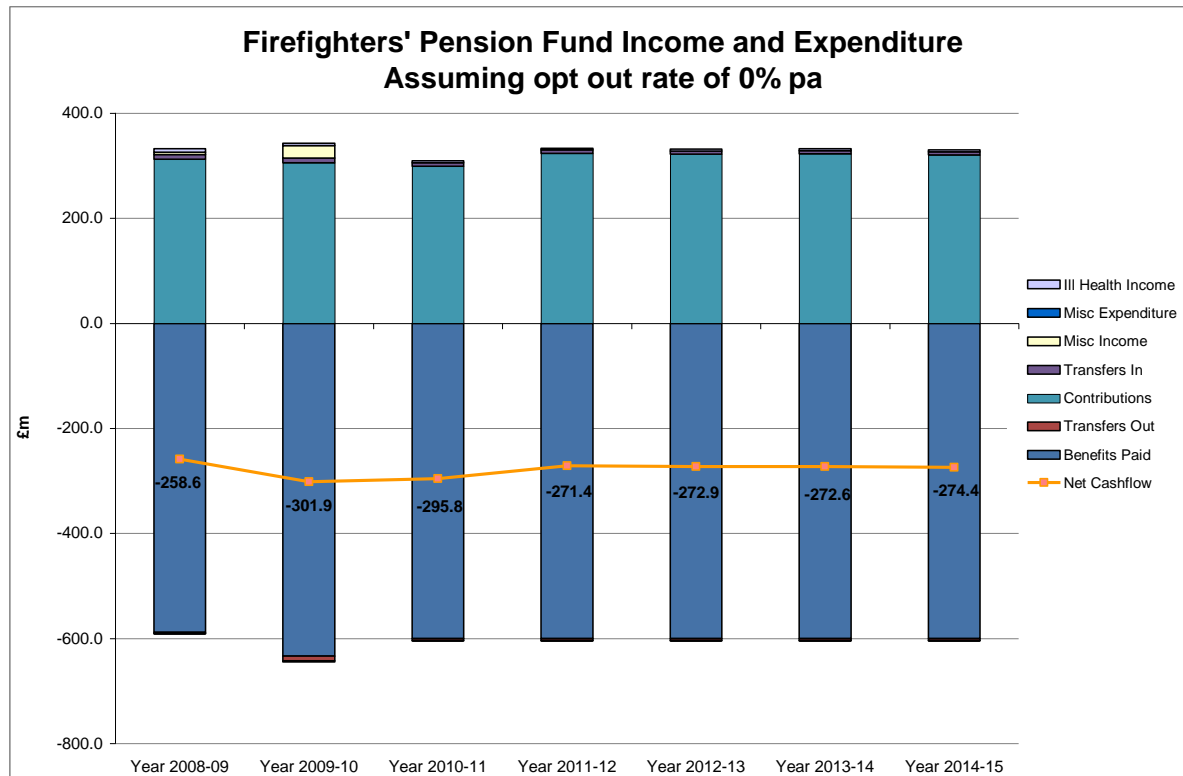
Source: Statistical Release; Friday 29 July 2011, Firefighters’ Income and Expenditure

We have then used pay bill projections provided to us by DCLG for 2011-12 onwards together with the increase in the weighted average contribution rates calculated in Question 1 above, to project the cash flow in the firefighters’ schemes for April 2012 to April 2015.

	10-11	11-12	12-13	13-14	14-15	15-16
Pay bill growth	3.2%	0.2%	-0.4%	0.1%	-0.6%	0.5%
Pay bill (£m)	1,050	1,052	1,047	1,048	1,042	1,047

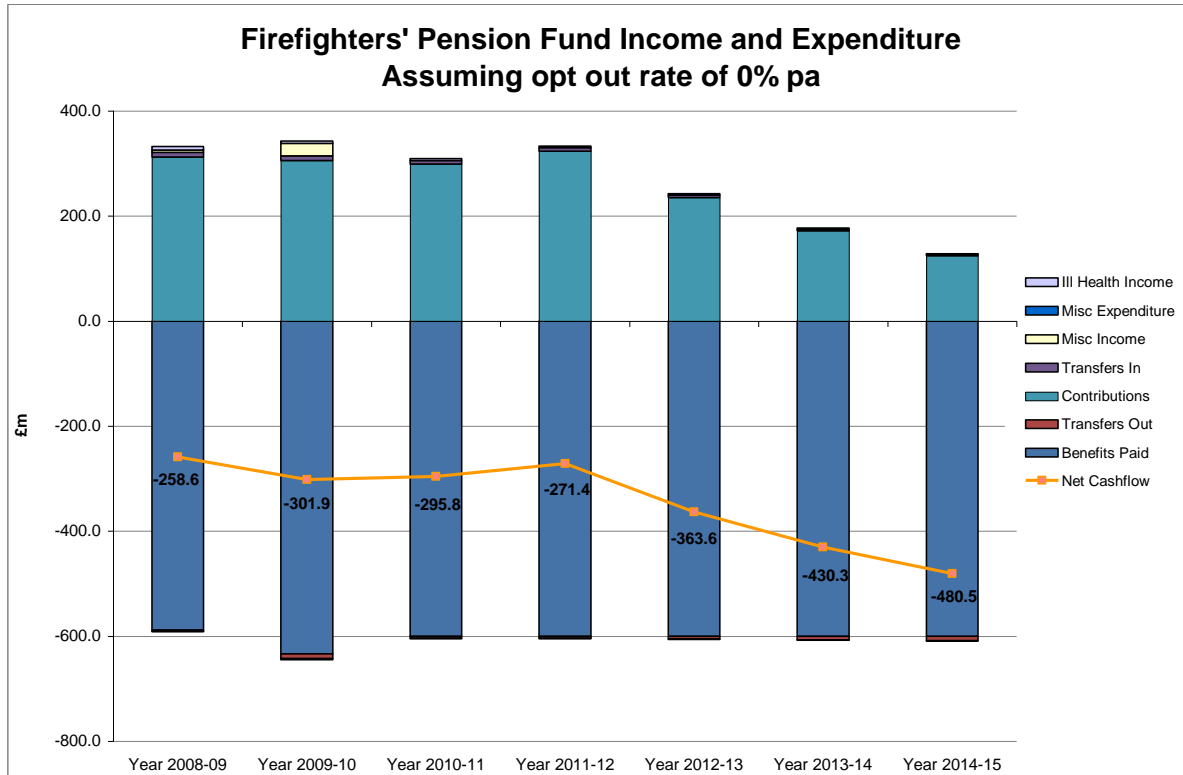
Source: DCLG, email dated 7 November 2011

The projected cash flow position of the schemes (assuming no opt-outs) for the period from April 2012 to April 2015 is therefore as follows:



The chart above shows that from April 2012 the net cash flow position of the schemes would remain fairly stable from -£271.4 million as at April 2012 to -£274.4 million as at April 2015.

Now, using the same projections, but this time assuming that there will be a year-on-year reduction in membership (and a corresponding reduction in employee and employer contributions into the schemes) at a rate of 27% a year, in line with the findings of the YouGov survey outlined above, the projected cash flow is as follows:



The chart above shows that from April 2012 the net cash flow position of the schemes would reduce from -£271.4 million as at April 2012 to -£480.5 million as at April 2015. This compares to -£274.4 million as at April 2015 assuming no opt-outs. This is a reduction of over £200 million.

As mentioned above, given that pensions (and other benefits) still need to be paid regardless of the contribution income received by the schemes, the savings that Government is aiming to achieve would be wiped out.

The above projections were based on pay bill projections provided by DCLG as set out above. It should be noted however, that recent statistics contained in DCLG's "Operational Statistical Bulletin", dated August 2011, showed that the number of firefighters fell from 43,875 at 31 March 2008 to 42,679 at 31 March 2011. The number of whole-time firefighters fell from 30,580 as at 31 March 2008 to 29,062 as at 31 March 2011. This represents a 2.7% reduction in firefighters (5.0% reduction in whole-time firefighters) over the four year period. If this trend continues, it would place further burden on taxpayers in meeting the negative cash flow position for the firefighters' pension scheme. We do not comment further on this here.

Aspirations for promotion

The rise in contributions is likely to have a detrimental effect on the ambitions of firefighters' promotion aspirations. If a firefighter receives a promotion and subsequently moves to a higher contribution band, the additional member contributions he would be required to pay could erode the increase in take-home pay.

The YouGov survey carried out on behalf of FBU showed that 62% of respondents said that the proposed contribution hikes would affect their decision to apply for promotion. This reflects the concern that a tiered contribution structure could result in contribution rates at the higher salary bands being a deterrent for career progression.

For example, a Station Manager (Competent A) in the FPS who moves in 2014-15 to Station Manager (Competent B) would receive a salary increase of £2,653 (£37,456 to £40,109) but will face an increase in contributions under the proposed tiered contribution structure from 14.5% to 15.0%. This is equivalent to an extra £585 in contributions, resulting in an increase in take-home pay of only £1,241 after tax. Other situations reveal similar results.

It may also be in the financial interest of some members to opt out of the scheme if the proposed increase in member contributions is implemented. For example:

- A firefighter who has reached the maximum number of years' service or is approaching retirement may be better off opting out and paying his member contributions into a personal pension plan. On reaching the maximum number of years' service a firefighter's pension will only increase if his salary at or near retirement increases.
- Often, close to retirement, a member's salary does not increase (or actually decreases if the member goes part time). Therefore the only real benefit of remaining in the scheme is the life cover provided (e.g. a lump sum of twice pensionable pay for FPS and three times for NFPS). However, it is likely that the firefighter would be able to obtain equivalent life cover from an insurance company for less than the potential increase in member contributions.

The proposed increase to employee contributions could encourage firefighters to look elsewhere for pension provision to find a package which can be tailored to their specific needs, and which they have full control over the amount they contribute.

Justification for tiered contribution structure in a CARE scheme

It is questionable whether a tiered contribution structure is justifiable in a CARE scheme which already aims at addressing the higher cost of pensions for those with higher salary growth and other expectations. Justification given for introducing tiered contributions so that higher earners pay a higher rate than lower earners often includes: higher salary growth expectation, longer life expectancy, and higher disposable income and higher rate tax relief.

However, CARE removes the need to protect against higher salary growth expectation, and counter arguments include that the experience of higher life expectancy is not statistically significant, it is unfair to suggest higher earners should pay a higher rate for effectively the same benefit and could be considered to be a way of removing the higher rate tax relief they enjoy on pension contributions.

If tiered contributions are introduced based on pay bands, then it is important that the range around the average employee contribution rate from the low earners to the higher earners, is designed such that it is justifiable. It could be argued that the proposed range from 11% to 17% for FPS members by 2014-15 is far higher than can be justified.

Q3. Do you consider that there are equality issues that will result in any individual groups being disproportionately affected by the proposed contribution tiers? If so, what do you consider to be the nature and scale of that disproportionate effect?

RESPONSE: We have considered the following points:

- Equality between lower earners and higher earners
- Equality between members of the FPS and the NFPS
- Equality between current members and new entrants from April 2015

Equality between lower earners and higher earners

Introducing a tiered contribution structure, by definition, means that higher earners will be asked to contribute more than lower earners. What can be considered “fair” in terms of the additional rate that higher earners can be asked to contribute compared to lower earners should be justifiable on the grounds of the cost of benefits being higher for higher earners as a percentage of pay.

It is often argued that higher earners have greater salary growth expectation and therefore the cost of benefits in a final salary scheme will be higher for higher earners than for lower earners. However, again, it is important that the range around the average employee contribution rate from the low earners to the higher earners, is designed such that it is justifiable. It could be argued that the proposed range from 11% to 17% for FPS members by 2014-15 is far higher than can be justified.

In Question 2 above, I outlined reasons why a tiered structure may not be justified for a CARE scheme. Therefore, it may not be wise to introduce a tiered employee contribution structure for the interim period between April 2012 and April 2015 when the proposed CARE schemes come into effect which may have flat employee contribution rates. This would introduce unnecessary confusion for employees.

Equality between members of the FPS and the NFPS

The Consultation Document comments that currently, members of the FPS pay less than 30% of the total cost of the Scheme whereas members of the NFPS contribute 37% of the total cost. The proposed tiered contribution structure effectively increases the weighted average employee contribution in the FPS from 11% to 14.5% (which represents around 39% of the total cost) and increases the weighted average employee contribution in the NFPS from 8.5% to 10% (which represents around 44% of the total cost).

The Consultation Document suggests that “...as the imbalance between employee and employer contributions is less for the NFPS, a lower increase for its members compared to the FPS seems more appropriate...”

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Lord Hutton comments in his Interim Report that a fair balance between employees and employers (and taxpayers) is 1:2 (i.e. 1/3rd employees and 2/3rds employers). The existing balance of costs is such that in the FPS employees pay marginally below 1/3rd of the total cost and members of the NFPS pay above 1/3rd of the total cost. Therefore, this would suggest that no increase should be asked of members of the firefighters pension schemes who already pay a fair balance of the cost.

Equality between current members and new entrants from April 2015

The Consultation Document does not provide information on the proposed structure of employee contribution rates in relation to the benefits building up from April 2015. It is expected that the cost of benefits building up after April 2015 will be lower than the current level of benefits and therefore it would be reasonable to expect a lower employee contribution rate to apply from April 2015.

At the very least, new entrants from April 2015 should not be required to pay a proportion of their pension contributions towards the retention of a final salary link for those members with benefits built up before April 2015. This would be grossly unfair and an easily avoidable cross-subsidy.

Q4. Is there a tariff which you think will help minimise any opt outs from the Firefighters' pension schemes?

RESPONSE: The FBU has not requested any information from First Actuarial on this question at this time

5. Is the treatment under the proposals of part time workers and retained Firefighters clear?

RESPONSE: The FBU has not requested any information from First Actuarial on this question at this time



Rob Hammond
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